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Business dynamism: is it really declining?

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When you read the news each day, you probably see a story devoted to the latest tech startup or a firm's recent billion-dollar valuation. But despite the media attention that startups and entrepreneurs receive, business dynamism—the churn in the economy as measured by firm entry, expansion, contraction, and exit—has slowed in recent years. In “[Declining business dynamism in the United States: a look at states and metros](#)” (The Brookings Institution, *Economic Studies at Brookings*, May 2014), authors Ian Hathaway and Robert E. Litan look at firm entry and job reallocation rates over the past 30-plus years and examine national trends along with state and metro-area trends to see if the decline is isolated to geographic areas.

The authors use Bureau of Labor Statistics Business Employment Dynamics and Census Bureau Business Dynamics Statistics to determine that 13.4 million private sector jobs were created or destroyed each quarter in 2012. A healthy churn in the economy is a good sign; new firms innovate and push out the weak firms. However, for each quarter in 2012, only 600,000 net jobs were created. Firm entry and exit rates from 1978 through 2011 reveal that firm exit rates were mostly stable over the period (with a noticeable increase during and after the Great Recession), but firm entry rates have steeply declined since 2006 and dipped below firm exit rates for the first time in the three-plus decades since the data series began.

Hathaway and Litan also measure business dynamism through job reallocation over the same 34-year span. (Job reallocation takes into account firm entries and exits as well as firm contractions and expansions.) In line with the decline in firm-entry rates, the job-allocation rate steadily declined during the 1978–2011 period. The authors question whether the declines can be attributed to a specific industry or firm size; however, they find that negative changes in firm-entry and job-allocation rates are spread wide across all industries and firm sizes.

The authors also checked to see whether differences in business dynamism exist among states and metropolitan areas. They found that declining business dynamism was present among all states and nearly all metro areas. Using the same timeframe as before (1978–2011), the first and last 3-year periods (1978–1980 and 2009–2011) were averaged together to give a start and end point and to reduce noise in the year-to-year data. Firm entry rates declined in all states and all but 1 metro region from the earlier period to the end, and job reallocation rates declined in all states and all but 12 metro areas.

What about the years between the two averaged start and end periods? The authors account for these years by using weighted standard deviations for firm entry, firm exit, and job reallocation rates to see if states and metro areas have similar trends and if the similarities (or differences) change over time. (Low standard deviations show similarity.) For all three measures, metro areas had higher standard deviations than those of the states, but the standard deviations increased and decreased together over time. The greatest difference in standard deviations between states and metros is shown in the job reallocation rate, which exhibits higher standard deviations than those of the entry and exit rates. Note, though, that the standard deviations for both states and metro areas steadily decreased over the time period, echoing the national decline in business dynamism. This also proves that states and metro areas performed more similarly to one another as the years passed.

In general, the decline in business dynamism over the past few decades has not been restricted to certain industries, firm sizes, or geographical areas. The authors conclude by acknowledging that the research does not provide detail about why these declines have occurred and that data collected past March 2011 could reveal new trends in business dynamism. They also encourage policymakers and entrepreneurs to embrace change and call for the government to enact policy that would enable entrepreneurs to thrive.